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Lingering credit crisis choking US economy

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Washington, Feb 4 (IANS) A lingering credit crisis is choking investment in moneymaking ventures that could help activate US economy mired in its worst downturn in decades, according to a new corporate survey.Nearly 60 percent of 569 US firms surveyed are financially strapped by the credit crunch, netting layoffs and other cost-cutting moves that weaken an already hobbled economy, according to research by University of Illinois and Duke University.

The survey also shows that tight lending is forcing nearly 90 percent of those credit-constrained firms to pass up potentially lucrative projects that could boost earnings, employment and the overall economy.

“We see what firms are doing in the aftermath of the credit crisis, but we don’t see what they’re not doing,” said Illinois university finance professor Murillo Campello. “And what this research shows is that what they’re not doing is pursuing projects that could help build and sustain the US economy for the next 10 years.”

“What this reveals is that the damage the credit crisis is causing to the corporate sector is perhaps much bigger than just the latest unemployment figures or stock-market prices would tell you,” he said.

As part of a survey project conducted jointly with CFO magazine, chief financial officers of 1,050 companies in the US, Europe and Asia were polled in December, asking whether their firms have been pinched by an ongoing credit crisis and how tight lending is affecting operations.

The study, co-written by finance professors John Graham and Campbell Harvey of Duke's Fuqua School of Business, found stark contrasts between US firms constrained by the financial crisis compared with those with easier access to credit.

• Just a few months into the crisis, constrained firms had burned through an average 20 percent of their cash holdings to pay suppliers, salaries and other operating expenses. Companies with access to credit had not touched cash reserves, keeping those firms on more solid financial footing.

• Nearly 17 percent of constrained firms have drawn on lines of credit - stockpiling cash out of fear that access could be limited in the future - compared with just five percent of unconstrained companies.

"This is a frightening trend," Harvey said. "Yes, credit is limited, but firms that hoard funds right now, instead of using them for investments and operations, are directly contributing to the downward cycle of the economy."

• Constrained firms plan cuts in operating costs this year that are roughly twice as deep as unconstrained firms. That includes slashing employment by 11 percent, research and development by 22 percent, marketing by 33 percent and dividends by 14 percent. Campello says the forecasts are likely conservative.

"Typically, CFOs are confident, they have a positive bias," he said. "So if they say the cut will be 10 percent, it's probably more like 20 percent."

Campello says the findings signal that the recession might linger longer than once thought, perhaps stretching into 2010.

Researchers say the study is likely the first to directly assess the impact of credit limitations through self-reports from CFOs. Typically, affects are gauged through a retrospective review of financial statements, according to a U of I release.

"Having this information helps us learn more about how companies make investment and financing decisions, and in this case revealed some startling details about the way corporations are responding to the crisis," Graham said.

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